"Factors Affecting the Quality of Internal Auditing in Yemeni Banks"

A Research Proposal for Ph.D. Admission

Submitted to:

Swami Ramanand Teerth Marthwada University

By:

Alaallah Ali Mansour Sharhan

1-1 Introduction

Corporate governance is exercised through four fundamental parties linked by cooperative relations: the external auditor, the Audit Committee, the Board of Directors, and the internal audit function (IIA, 2003a).

Internal audit function can contribute to improving the quality of corporate governance through collaborative relations with the other three parties of governance. This improvement can be achieved by supporting these parties to perform their role in the corporate governance. As a matter of fact, the recent studies have confirmed it, as they pointed out that the positive influence of the internal audit function on corporate governance is obviously to improve the financial reporting and to develop the effectiveness of the performance (see for example: Schneider and Wilner, 1990; Hansan, 1997; Antoine, 2004; O'Leary and Stewart, 2007). Besides, the importance of the role of the internal audit function has increased with new requirements imposed by the law "Sarbanes-Oxley Act of 2002" on the companies.

Internal audit function must be integrated with other parties which are responsible for corporate governance (Va1llario, 2003). Therefore, to get the internal audit function a powerful tool to support other parties of the corporate governance, it must be characterized by an appropriate level of quality. This means that the quality of the internal audit function affects the relationship with the other three government parties and then the quality of corporate governance is affected. In order to play this pivotal role, the internal audit function should have properties or certain factors that lead to improved quality, and thus improve the quality of its relationship with other parties, which is reflected to improve the quality of corporate governance.

Moreover, the IIA standards require the executive internal audit to ensure and improve the quality of the internal audit function, which includes periodic assessment of the quality of the internal audit function and the ongoing internal monitoring (IIA, 2003 b).

Beyond that, both management and Audit Committee have an effective role in internal audit function, through the decisions of the resource allocation and determining the level in which the internal audit reports raised to.

Professional standards for each of the internal and external audit have identified the necessary factors to ensure the quality of the internal audit function, and it identifies the list of auditing standards (NO.65, AICPA, 1991). The factors of quality internal audit function include:

1- Competence which is measured by educational level and professional certificates.
2- Objectivity which is measured by the parties that addressed the internal audit report to them and the parties that are responsible for the appointment of internal auditors.
3- Quality of performance of tasks, which is measured by the accuracy and adequacy of audit programs and the scope of audit (AICPA, 1991).

Similarly, the standards of the Institute of Internal Auditors IIA identified the factors of quality of audit functions: a) independence, b) objectivity, c) proficiency, and d) diligence (IIA, 2003b).

Quality of the internal audit function has gained interest of many previous studies as a lot of these studies used two approaches: The Survey Portal and the Experimental Portal. These approaches are used for determining whether and how the external auditor integrates the three aforementioned factors while assessing internal audit quality for quality of the internal audit function identified by the external audit standards (SAS No. 9 AICPA, 1975; SAS No. 65 AICPA, 1991).

On the other hand, from the previous studies, some have relied on testing the quality of judgments and decisions of internal auditors for the purpose of assessing the quality of the internal audit function. These studies

have used the second approach, the Experimental portal which focused on objectivity, morality and ethical thinking, entirety of judgments and decisions of internal auditors.

Investigating audit quality in Yemeni banking sector is significant based on the importance of reaching a high quality auditing process. One of the significant sectors in Yemeni is the banking sector, this sector is vital to the Yemeni economy. Moreover, the Yemeni banks have an effective role in the transmission of monetary policy. Consequently, one can argue that auditors are vitally important to the banking sector.

1-2 Significance of the Study

Significance of the study focuses in two aspects which can be illustrated as follows:

1. Scientific Significance.
2. Practical Significance.

1- Scientific Significance

The Scientific significance of this study comes to keep up with the most modern international debates to activate the quality of internal audit as it is one of corporate governance and effectively contribute to reduce risk. Particularly, in the banks with high adventure characteristics activities for they deal in cash. Their activities have spread recently and become a major pillar in saving the national economy.

The scientific significance of this study can be presented under the following points:

1. According to the researcher's knowledge, this study is the first attempt that aims to discover the factors which affect the quality of internal audit in Yemeni banks and endeavor to measure the effect of these factors.

2. This study comes to keep up with development in concepts and modern scientific of management theories, that is endeavor to corporate banks and companies. Internal audit is the most important tools in the context.
   The study will follow a qualitative modern approach concerns both the vocational international and the governmental organizations for such thing is found to be of a great significance particularly with the external audit. Unlike the external audit, the internal audit has not got such concern. This study will contribute in enhancing the epistemological need for determining the effective factors that affect the quality of the auditing and quality mechanism enhancement of the banks.

2- Practical Significance

The practice significance of this study would briefly be through as:

1- It comes in accordance with the central bank policy and interest. It would be practically identical to the central bank booklet No. (6) instructions issued in 2013 which obligates that all banks must facilitate the establishment of vital internal auditing process with functional effective governance.
2- The study is expected to be in accordance with the World Bank recommendations which emphasize the activation of the institutional principles, the banks governance and the monitoring systems, especially the monitoring system of the internal auditing.
3- The study is supposed to find out the factors which affect the quality of internal auditing in banks. Consequently, findings would explore the causal factors of such effect. Hence, it would be possible to generate the appropriate tools to eliminate such a passive effect and enhance the positive factor. Through improving the existing performance and function of those factors. In case of having difficulties achieving such thing, the process of generating and supplying new more alternative factors might be applied so as to

accomplish and fulfill the wanted purpose according to the common standards of auditing.

4- The findings and recommendations of the study would be a major referencing framework for improving the quality of the internal auditing either for the targeted administrative council of banks or for the central bank of Yemen. The study would also play a pivotal role in enabling those auditors who are under the study, to perform a precise systematic work with better results. Since the population of the study is signified in three independent samples, the outcomes represented are more reliable and credible.

1-3 Statement of the Problem

(SAS, 65, AICPA, 1991) mentioned three standards of internal of activities: quality of work performance, Objectivity, Competence. On the other hand, (IIA, 201) referred to that the quality of the internal audit activities is linked to the availability of the general characteristics in the standard of internal audit, which is concerned about giving instructions to banks. Bazel committee has recommended activating the role of internal audit and emphasized the importance of getting support from administration, independence vocational training, and enhancing the ethical concepts.

There are many research studies which aimed at evaluating and determining the factors which affect the quality of internal audit activities, some of these studies examining the factors and the risks while others pointing out their relationship with improving performance, and mostly their external audit. The findings of studies previous have also that the factors that affect the quality of auditing differ from one sector to another.

The banking sector is considered the most interested and necessary sector for internal auditing since its activities are of high risks and require quality, experience, and planning. Therefore, we find that central bank of Yemen, after the collapse of the national bank in 2009 and the financial crisis

that hit US and Europe banks in 2011, has emphasized the necessary to strengthen monitoring systems and the principles of corporate governance in banks. The internal auditing has wide range of targets which can be early achieved by the quality of internal auditing. It is influenced by several factors as it is related to nature and activities of banks. Others related to the characteristics for internal auditors itself, and also factors are related to internal audit itself with have significant and essential function. For improving the quality internal auditing performance, we must explore the factors which affect as negative or positive it to enhance the positive, explore the causes a negative effect, and find the procedure that may be reduce of that affect.

The present study attempts to find out the affecting factors that lead to improving the quality of internal auditing. The questions of the study are being put as it follows:

- What are the factors that affect the quality of internal auditing in the Yemeni banks?
- Are there any significant differences in the important of factors which affect the quality of internal auditing, and which may be ascribed to the ownership of the bank whether private or public?
- Are there any similarities between the factors that affect the quality of internal auditing in the Yemeni environment and these of other Arab and international ones?

1-4 Objective of the Study

The current study aims to explore the factors that affect the quality of the internal auditing in Yemen banks. It aims:

1- To determine the factors that affect the quality of internal auditing in banks whether they are relevant to the characteristics of auditors or auditing functions itself and structured work in banks.

2- To find out the most affecting factors on the quality of internal auditing in banking sector and discover the causes of existing factors.
3- To measure the quality of internal auditing in Yemeni banks depending on modern concepts of quality internal auditing and objectives of banks.
4- To provide practices and scientific recommendations for banking sector on the basis of the results that will be drawn from the present study.

1-5 Hypothesis of the Study

It is hypothesized that "there are no a significance relationship between the factors related to characteristics of internal auditors, internal auditing function, structure banks, and the quality of internal audit. This hypothesis is divided into the following sub-hypotheses:

1- H_1: There is not a significant relationship between the efficiency of internal auditors and the quality of internal audit.
2- H_2: There is not a significant relationship between the independence of internal auditors and the quality of internal audit.
3- H_3: There is not a significant relationship between the objectivity of internal auditors and the quality of internal audit.
4- H_4: There is not a significant relationship between the ethics of auditors and the quality of internal audit.
5- H_5: There is not a significant relationship between the ethics thinking and the quality of internal audit.
6- H_6: There is not a significant relationship between the extent of auditing and the quality of internal audit.
7- H_7: There is not a significant relationship between the superiority of management support and the quality of internal audit.
8- H_8: There is not a significant relationship between the coordination with Audit committee and the quality of internal audit.
9- H_9: There is not a significant relationship between the efficiency internal control system and the quality of internal audit.

10-H_9: There is not a significant relationship between control structureand the quality of internal audit.

1-6 Model of the Study

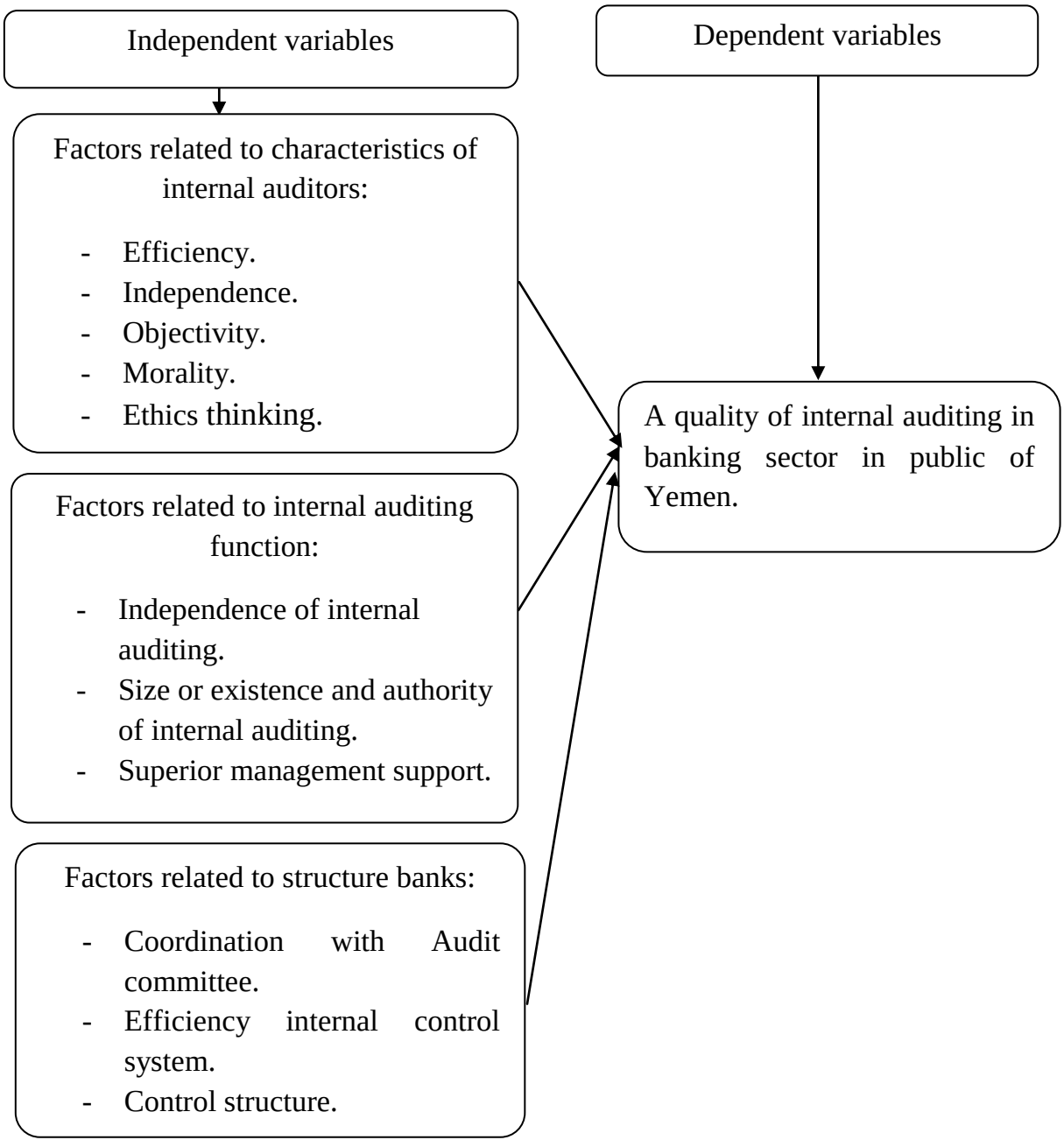
Independent variables
Dependent variables
Factors related to characteristics of internal auditors:
- Efficiency.
- Independence.
- Objectivity.
- Morality.
- Ethics thinking.
Factors related to internal auditing function:
- Independence of internal auditing.
- Size or existence and authority of internal auditing.
- Superior management support.
Factors related to structure banks:
- Coordination with Audit committee.
- Efficiency internal control system.
- Control structure.
A quality of internal auditing in banking sector in public of Yemen.

Fig. 1. 1Model of the study

1-7 Methodology of the Study

The present study is based on descriptive analysis of data.

1-7-1 Population of the Study

Population of the study consists of all banks in Yemen and are authorized from Central Bank of Yemen until the end of 2015. The following table shows the names of these banks:

Table 1: Population of the study for all banks in Yemen

No.	Bank Name	City
1.	Alkuraimi Islamic Microfinance Bank	SANAA
2.	Arab Bank Plc - Yemen	SANAA
3.	Bank of Yemen	ADEN
4.	Central Bank of Yemen	SANAA
5.	Cooperative and Agricultural Credit Bank	SANAA
6.	International Bank of Yemen Y.S.C.	SANAA
7.	Islamic Bank of Yemen for Finance and Investment	SANAA
8.	National Bank of Yemen	ADEN
9.	Qatar National Bank Saq	SANAA
10.	Rafidain Bank	SANAA
11.	Saba Islamic Bank	SANAA
12.	Shamil Bank of Yemen and Bahrain	SANAA
13.	Tadhamon International Islamic Bank	SANAA
14.	United Bank Limited	SANAA
15.	Yemen Bank for Reconstruction and Development	SANAA
16.	Yemen Commercial Bank	SANAA
17.	Yemen Gulf Bank	SANAA
18.	Yemen kuwait Bank for Trade and Investment Y.S.C.	SANAA
19.	Yemen Kuwait Bank-Islamic Branch	SANAA

1-7-2 Sampling of the study

It includes internal auditors who are in internal auditing function at main center of banks and members of the audit committee in the banks as well as external auditors by the Central Bank of Yemen.

The samples of the study can be drawn in table below:

Table 2: General perception of the target sample

Name	Type of job
Internal auditors	Into the banks
All Members in audit committee	Into the banks
External auditors by Yemeni Central Bank	Outside the banks

1-8 Collection of data

The present study follows two methods in collecting the data:

1- **Primary Data:** As this study both theoretical and practical, the researcher will collect the primary data by using the inductive method. For this purpose, two models of the questionnaire will be designed. The items of the questionnaire are structured on the basis of international accounting and auditing standards, and American standards issued by the American Institute of Internal Certified Public Accountants, Organization for Economic Cooperation and Development OECD standards and the Yemeni official laws. The researcher will also utilize the theoretical background in building the tool of the study. The researcher will use the questionnaire as a main tool to collect primary data from the sample of the study as well as interview with internal auditing managers in the banks.

2- **Secondary Data:** This type of data will be collected from a set of Arabic and English books, periodicals, international accounting and

auditing standards, OECD principles, existing scholarship in the field, and the relevant official laws and regulations. The study also benefits from the material available online.

1-9 Analysis of Data

The present study will use statistical tools for analyzing data and testing hypotheses of the study:

- Descriptive statistics:
  - Frequency and percentage.
  - Arithmetic mean and standard deviation
- Statistical inference
  - Measures of Dispersion.
  - Correlation Analysis.
  - Regression Analysis: such as simple regression and multiple regressions.
  - One way Anova.
  - Factors Analysis.

1-10 The Scope and Limitations of the study

The temporal and situational limitations of the study will be embodied in the following:

1- The study will be limited only on exploring and investigating the influencing factors on the quality of the internal auditing. It focuses upon them as independent variables in the following related points:
   - The relevant previous studies.
   - The scientific theories of auditing such as the conflict over interest theory and theory of representativeness and agency.

- Veins and recommendations of the professional organizations.
- The Yemeni laws, with direct relevance with the internal auditing quality, which organize their work as the law No. (5) of the year 2012 concerned with organizing the public sector internal auditing work.

2- The concept of the study will cover the quality of the internal auditing according to the professional practices that quality is not achieved without achieving the purposive goals.
3- Questionnaire will be the main tools to conduct the study.
4- Population of the study will be limited to the general administrations of the banks.

1-11 Scheme of the study:

The present study will be divided into six chapters as following:

- Chapter One: Introduction.
- Chapter Two: Review of Literature.
- Chapter Three: Quality of Internal Auditing.
- Chapter Four: Factors Affecting the Quality of Internal Auditing.
- Chapter Five: Data Analysis and Hypothesis Test.
- Chapter Six: Conclusion and Recommendations.

AICPA: American Institute of Certified Public Accountants

SAS: Statement on Auditing Standards